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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 145

WILL G. REA AND FRANK FORESMAN, AS TRUSTEES OF THE REA & READ MILL AND ELEVATOR COMPANY, A CORPORATION, DISSOLVED,

Petitioner,

v.

ACEL C. ALEXANDER, COLLECTOR OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

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Petitioners, by their attorney of record, pray that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit, entered in the above-entitled cause on March 18, 1940.

Opinion Below.

The opinion of the District Court of the United States for the Western District of Oklahoma (R. 163) was rendered on September 17, 1938, and is unreported. The opinion of the Circuit Court of Appeals (R. 289-294) is reported in 110 F. (2d) 898.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered March 18, 1940. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

A. Is the court without jurisdiction to review a determination of the Commissioner of Internal Revenue made under the special assessment provisions of the Revenue Act of 1918 (Sections 327-328), where such determination results in a tax liability in excess of the amount due when computed at the normal rates and without the benefit of the special assessment provisions?

B. Was the determination of the tax liability as set forth in the letter from the Commissioner, dated December 7, 1925 (R. 251-253), a *final determination* of such tax liability under the special assessment provisions of the Revenue Act of 1918?

C. Is the court without jurisdiction to entertain an action for the determination of the true tax liability where there has been *no final determination* by the Commissioner of such tax either at the normal rates (Sections 301-302) or under the special assessment provisions of the Revenue Act of 1918?

Statutes.

The statutes involved are set forth in the Appendix, *infra*, pp. 13-14.

Statement.

On April 1, 1918, the Elevator Company sold a tract of land, on which its milling plant was located, to the Railway

Company for a consideration of $65,000.00. The sale did not include the plant (R. 33-35). On April 5, 1918, the Railway Company and the Elevator Company entered into a written lease whereby the former leased to the latter the ground purchased for a term of two years at a rental of $250.00 per month. The lease gave the Elevator Company the privilege of renewal at the end of the two-year term for one year or longer, provided the Railway Company should not then need the land for railroad purposes. It recognized the right of the Elevator Company to remove the buildings from the leased premises and provided that the Elevator Company might terminate the lease on thirty days' written notice to the Railway Company, and that upon such termination and removal of the buildings by the Elevator Company, further liability for rent should cease (R. 269-273).

In June 1920 the lease was terminated and the company sold the remaining physical assets, including the buildings, for $25,000.00 (R. 35).

On April 30, 1919, the Elevator Company filed its income and profits tax return for the year 1918, disclosing a net income of $16,137.73 and a tax liability of $3,228.59, which it paid (R. 131).

On June 18, 1920, following the sale of the remaining physical assets, the Elevator Company filed its corrected income and profits tax return for 1918, disclosing a corrected net income of $15,980.34 and a corrected tax liability of $3,079.93 (R. 133).

On October 18, 1923, a revenue agent made a report on the Elevator Company's income for the year 1918. He included in such income the $65,000.00 received from the sale of the land to the Railway Company and found the March 1, 1913 fair market vaule of such land to be $26,000.00, and the profit derived from the sale to be $39,000.00. He determined the net income of the Elevator Company to be $56,-

914.95 and proposed an additional tax of $33,837.33. On November 6, 1923, a copy of the report was furnished to the Elevator Company. On February 2, 1924, the Commissioner advised the Elevator Company that the additional tax liability of $33,837.33, proposed by the revenue agent, had been approved (R. 135-138).

Thereafter, the Elevator Company, from time to time, lodged protests and claims with the Commissioner in which it asserted that the March 1, 1913 valuation of the land should be fixed at $50,000.00, and since it was required to dismantle and remove the milling plant at the end of the term of the lease, that it should be allowed a deduction equal to the January 1, 1918 value of the buildings and equipment on the leased premises, less their salvage value allocated to the years 1918 and 1919. It submitted with one protest an appraisal of the land and the plant made by the Southwestern Appraisal Company in 1919, wherein the Appraisal Company fixed the March 1, 1913 valuation of the land at $50,000.00 and of the buildings at $57,157.33 (R. 138-141, 142-143).

The Commissioner refused to accept the report of the Appraisal Company on the ground that it contained no inventory on the date made, failed to show the manner of eliminating subsequent additions, gave no dates of acquisition or other information necessary to establish values, and did not conform with T. D. 3367 (R. 141-142).

Upon the recommendation of the Revenue Agent in Charge, dated January 15, 1924 (R. 137), the Commissioner finally accepted (R. 144) and the District Court has found (R. 154) a March 1, 1913 land value of $50,000.00.

On April 2, 1924, the Elevator Company asserted that computation of the taxes under Sections 301 and 302 would result in an abnormal profit being taxed at a rate in excess of 60 per cent (R. 143).

On November 22, 1924, the Commissioner advised the Elevator Company that its application under Section 327 for assessment of its profits tax for the year 1918 under the provisions of Section 328 had been allowed and that an audit of its tax liability for the year 1918 disclosed a deficiency of $26,941.45. The tax was again determined upon a net income of $56,914.95 (R. 143-144).

On January 5, 1925, the Commissioner addressed a letter to the Elevator Company proposing a deficiency of $26,941.45 and advising that the Elevator Company had 60 days within which to appeal to the United States Board of Tax Appeals. A petition for review by the Board of Tax Appeals was thereafter timely filed by the Elevator Company (R. 144).

Before the petition for review came on for hearing before the Board of Tax Appeals, the Acting Commissioner of Internal Revenue on August 12, 1925, addressed a letter to the Elevator Company advising that in view of representations made by the internal revenue agent in charge at Oklahoma City, the profit realized on the sale of the land had been reduced in the amount of $24,000.00, and that after giving effect to the reduction, the additional tax amounted to $14,061.31. Attached to the letter was a statement showing the adjusted net income to be $32,914.95, after deducting $24,000.00 from the amount previously determined. The letter further advised that if the Elevator Company would withdraw its appeal to the Board of Tax Appeals the deficiency would be computed in accordance with the attached statement (R. 144). On September 12, 1925, the Elevator Company withdrew its appeal (R. 144).

In a letter to the Commissioner dated September 24, 1925, W. B. Paul, Esq., attorney for the Elevator Company, acknowledged receipt of the Acting Commissioner's letter, stated that the appeal had been withdrawn, pointed out that

the statement attached to the Acting Commissioner's letter showed a computation of tax under Section 301 instead of Section 328, stated that the change in income did not eliminate the abnormal profit, but merely reduced the amount thereof, and that almost 50 per cent of the taxable income resulted from the sale of the land held prior to March 1, 1913, made, not because of a favorable market due to war conditions, but under threat of condemnation proceedings by the Railway Company, and requested that the case be returned to the Special Assessment Section (R. 145, and Ptf. Exh. 20, R. 247-249).

On October 9, 1925, the Commissioner acknowledged receipt of Mr. Paul's letter and advised that pursuant to the request therein contained, the case was being considered under the provisions of Sections 327 and 328 (R. 145, and Ptf. Exh. 21, R. 249).

On December 7, 1925, the Commissioner addressed a letter to the Elevator Company advising it that a reaudit of its income and profits tax return for the year 1918 had resulted in a deficiency in tax of $10,466.34 as shown by a statement attached to the letter. This computation by the Commissioner was based on an adjusted net income of $32,914.95 and was made without giving effect to the statutory provisions requiring allowance for depreciation of the physical assets over the life of the lease (Section 234 (a) (7)) and postponement of the determination of gain or loss in 1918 until the sale was consummated in 1920 (Section 213 (a)) (R. 245, 251-253). The statement attached to the letter contained the following:

> "However, the limitation of time within which to assess any additional tax which may be found to be due precludes a careful consideration of all the facts in the case. It is, therefore, requested that you execute and return to this office within fifteen days from the date of

> this letter the enclosed form of waiver by which you will note that you agree to an extension of time within which additional tax may be assessed, if any is found to be due, to December 31, 1926, except as provided in the form of waiver'' (R. 253).

Enclosed with the said letter was a standard blank form for the use of the taxpayer in the event it elected to consent to an immediate assessment of the proposed deficiency (R. 252).

On December 29, 1925, the Elevator Company elected to forward to the Commissioner the consent form duly executed upon which it had endorsed the following statement:

> ''The undersigned taxpayer does not waive the right to file a claim for refund in the amount of $10,466.34, or any other amount properly subject to refund'' (R. 145-146).

The proposed deficiency of $10,466.34 was thereupon assessed. This amount, with interest of $43.71, totalling $10,510.05, was paid on April 26, 1926, $9,009.15 and on July 8, 1926, $1,500.90 (R. 128).

The true net income of the Elevator Company for the year 1918 was $3,598.53 (R. 148) and the true tax liability computed at the normal rates was $71.82 (R. 149). The tax as computed by the Commissioner and paid by the Elevator Company was $13,694.03, resulting in an overpayment of $13,623.11 (R. 149).

On February 26, 1928, the Elevator Company filed a claim for refund of $10,466.34, the amount paid within the statutory period for filing a claim. The claim was based on the contention that its milling plant had a life of 24 months from April 1, 1918, the term of the lease from the Railway Company, and that it was entitled to a depreciation of the value of the plant, less its salvage value of $6,000.00, allocated to the years 1918, 1919 and 1920 (R. 254-277).

On April 16, 1930, the Elevator Company filed another claim for refund, in which it made the additional assertion that it was entitled to offset from the amount received for the land, in addition to its March 1, 1913 value, the March 1, 1913 value of the milling plant less its salvage value (R. 279-285). This claim was rejected on September 19, 1930 (R. 285-286).

On April 17, 1931, the trustees brought this action against Acel C. Alexander, Collector of Internal Revenue, to recover the sum of $10,466.34, with interest on $9,009.15 from April 26, 1926, and on $1,457.19 from July 8, 1926 (R. 8-12).

In his answer, the Collector alleged that the taxes sought to be recovered had been computed by the Commissioner under the provisions of Sections 327-328 on an application of the Elevator Company for such a computation, and that the Elevator Company had thereby waived its right to a judicial review of the Commissioner's determination (R. 16-17). The District Court found for the taxpayer, but the Circuit Court of Appeals reversed the decision (R. 295).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1) In holding that the Elevator Company "sought and *obtained relief* under Sections 327 and 328" of the Revenue Act of 1918 (R. 294).

2) In failing to recognize the established fact that there has been no final determination by the Commissioner of Internal Revenue of the true tax liability of the Elevator Company either at the normal rates or under the special assessment provisions of the Revenue Act of 1918.

3) In reversing the conclusion of the District Court that "As a matter of law the gain or loss from the disposition of the assets located on the land to the railroad and operated

under a two year lease from the railroad, could not be determined until the expiration of the lease in 1920 or the sale of the remaining assets to others in 1920'' (R. 154).

4) In failing to adopt the finding of facts by the District Court that the true net income of the Elevator Company for the year 1918 was $3,598.53, and the true tax liability $71.82, resulting in an overpayment of $13,623.11 (R. 146-149).

5) In concluding as a matter of law that the District Court was without jurisdiction to entertain the action.

6) In reversing the judgment of the District Court.

Reasons for Granting the Writ.

The decision of the court below, reversing the District Court, is in conflict with prior decisions of this Court, the Circuit Court of Appeals for the Ninth Circuit, the Court of Claims and decisions of several of the District Courts, based on the authoritative decisions of this Court.

1) The decision of the court below that the court is without jurisdiction to review the determination of the Commissioner under Section 328 of the Revenue Act of 1918, in a case where, as here, there has been no final determination of true net income is in conflict with the decisions of this Court in *United States* v. *Henry Prentiss & Company*, 288 U. S. 73; *Welch* v. *Obispo Oil Co.*, 301 U. S. 190 and *Heiner* v. *Diamond Alkali Co.*, 288 U. S. 502; the decision of the Circuit Court of Appeals for the Ninth Circuit in *U. S.* v. *A. J. Gutzler et al., Trustees*, 105 F. (2d) 188; and the decision of a district court in *American Chemical Paint Co.* v. *McCaughn* (D. C., E. D. Pa.), 24 Fed. Supp. 258.

> "* * * The Commissioner cannot make an administrative finding upon the question for decision under Section 327(d) or that under 328 until he has deter-

mined the net income of the taxpayer" *Heiner* v. *Diamond Alkali Co., supra,* p. 506, citing *United States* v. *Henry Prentiss & Company, supra.*

Until he has determined or there has been an agreement as to net income the Commissioner is in no position to compare the net income of the taxpaper with corporations that might be deemed to be representative in order to determine abnormality or gross disproportion between capital and income. *Id.*

> "* * * the taxpayer's true net income is an essential factor in the determination of his liability under sections 327 and 328;" *Welch* v. *Obispo Oil Co., supra,* pp. 195-196.

In the case of *A. J. Gutzler et al., Trustees, supra,* in which the facts are practically on all fours with the case at bar, Circuit Judge Healy, in a concurring opinion, correctly interprets and applies the rule laid down by this Court in the cases hereinabove cited, as follows:

> "* * * The taxpayer's true net income is undoubtedly an essential factor in the determination of his liability under an assessment made pursuant to Section 210 of the 1917 act. *Welch* v. *Obispo Oil Co.,* 301 U. S. 190; *Heiner* v. *Diamond Alkali Co.,* 288 U. S. 502. It is substantially shown that the Commissioner made no final determination of this essential factor. The matter remained in abeyance and *there never has been a final determination* by the Commissioner *of true net income.* This being so, there is no merit in the Commissioner's second defense" p. 193. (Ital. Supp.)

2) The decision of the court below that the court is without jurisdiction to review the determination of the Commissioner under the special assessment provisions of the Revenue Act of 1918 where, as here, the taxpayer protested such determination and can establish the fact of overpay-

ment without the benefit of the special assessment provisions, is in conflict with the decisions of the United States Court of Claims in *Daily Pantagraph, Inc.* v. *United States,* 37 F. (2d) 783, and of the District Court of Connecticut in *McKeever* v. *Eaton,* 6 Fed. Supp. 697.

The mere fact that a taxpayer pays the amount which is demanded by the Commissioner does not show an acceptance by the taxpayer of the rulings of the Commissioner under the special assessment provisions. Where the facts show, as here, that the case did not rest on the determination of the Commissioner there is nothing to prevent the taxpayer from maintaining an action to recover an overpayment in fact. *Daily Pantagraph* v. *United States, supra,* p. 788. Where the taxpayer completely ignores the special assessment determination, has never accepted the same, is not asking the court to apply its provisions and is asking for no relief under the special assessment provisions, it is not barred from the right to have its true tax liability judicially determined at the normal rates. *McKeever* v. *Eaton, supra,* pp. 701-702.

3) The decision of the court below that the court is without jurisdiction to review a determination of the Commissioner under the relief provisions of the Revenue Act of 1918 where, as here, his determination under those provisions results in a detriment as opposed to relief is in conflict with the true intendment of the pertinent sections of the Revenue Act.

The special assessment sections of the Revenue Act of 1918 were adopted for the express purpose of permitting the Commissioner to grant relief to a taxpayer because of some abnormality of either invested capital or income or both and may not be resorted to for the purpose of defeating a claim that there is no tax liability for the year involved. *United States Paper Exports Ass'n.* v. *Bowers,*

(D. C. S. D. N. Y.), 6 Fed. Supp. 735, disposed of on other grounds (C. C. A. 2), 80 F. (2d) 82.

4) The inferential holding by the court below that there was or could have been a final determination of tax liability under the special assessment provisions of the Revenue Act of 1918, without there first having been a final determination of statutory invested capital and statutory net income, is in conflict with the plain provisions of the statutes and the practice and procedure in the office of the Commissioner.

Section 327 of the act provides in subdivision (d) that the tax shall be determined in accordance with Section 328 "where upon application by the corporation the Commissioner finds and so declares of record that the tax *if determined without the benefit of this section would*, owing to abnormal conditions affecting the capital or income of the corporation, *work upon the corporation an exceptional hardship* evidenced by gross disproportion between the tax computed *without* benefit of this section and the tax computed by reference to the representative corporations specified in Section 328" *infra* p. 13. (Ital. Supp.) The Commissioner could not and, as a matter of general administrative procedure, would not consider a request for special assessment and final determination of the tax liability under these sections "until statutory net income and invested capital are definitely determined" (*United States* v. *Henry Prentiss & Company, supra*, p. 81) or the Commissioner's determination had been acquiesced in by the corporation. (*Michigan Iron & Land Co.* v. *U. S.*, 10 Fed. Supp. 563, 566.)

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be granted.

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June, 1940.